Nos. 84-801 and 84-805

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

MIDLANTIC NATIONAL BANK,

Petitioner (No. 84-801),

vs.

THE NEW JERSEY DEPARTMENT OF ENVIRONMENTAL PROTECTION,

Respondent,

and

THOMAS J. O'NEILL, TRUSTEE IN BANKRUPTCY OF QUANTA RESOURCES CORPORATION, Debtor,

Petitioner (No. 84-805),

vs.

THE CITY OF NEW YORK and STATE OF NEW YORK, *et al.*,

Respondents.

On Writs of Certiorari to the United States Court of Appeals For the Third Circuit

BRIEF OF PETITIONER, MIDLANTIC NATIONAL BANK

A. DENNIS TERRELL
Counsel of Record for Petitioner,
Midlantic National Bank
131 Madison Avenue
Morristown, New Jersey 07960-1979
(201) 285-1000

SHANLEY & FISHER, P.C.
Attorneys for Petitioner
Midlantic National Bank

KENNETH S. KASPER
Of Counsel and
On the Brief

Adams Press Corp., 1188 Raymond Boulevard, Newark, New Jersey 07102—(201) 623-8611

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FEBRUARY 19, 1985

Questions Presented for Review

1. Whether the Third Circuit Court of Appeals erred in holding that a bankruptcy trustee's ability to abandon burdensome and valueless property under 11 U.S.C. §554 is conditioned upon compliance with state environmental regulations?

2. Whether the Third Circuit Court of Appeals erred in interpreting 11 U.S.C. §554 and 28 U.S.C. §959(b) so as to raise a substantial question as to the taking of property without just compensation in sharp conflict with the decision of this Court in *United States* v. *Security Industrial Bank,* 459 U.S. 70, 103 S.Ct. 407, 74 L.Ed.2d 235 (1982)?

Parties

The parties who appeared before the Third Circuit Court of Appeals in Case No. 83-5730 are listed below.

The New Jersey Department of Environmental Protection, Appellant.

Thomas J. O'Neill, Trustee for Quanta Resources Corporation, Appellee.

Midlantic National Bank, Appellee.

James V. Frola and Albert Von Dohlin, Appellees.

The parties who appeared before the Third Circuit Court of Appeals in Case No. 83-5142 are listed below.

The City of New York and the State of New York, Appellants.

Thomas J. O'Neill, Trustee for Quanta Resources Corporation, Appellee.

The State of New Jersey, *Amicus Curiae.*

The Commonwealth of Pennsylvania, *Amicus Curiae.*

The Department of Environmental Resources of the Commonwealth of Pennsylvania, *Amicus Curiae.*

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BRIEF OF PETITIONER, MIDLANTIC NATIONAL BANK

Opinions and Judgment Below

The opinion of the Third Circuit Court of Appeals in the action involving the New Jersey property, Case No. 83-5730, is reported at 739 F.2d 927 and is set forth at pages 35a to 40a of the appendix to the Petition of Trustee Thomas J. O'Neill ("the Trustee"). The amended judgment of the Court of Appeals in that case is set forth at pages 47a to 48a of the appendix to the Petition filed by the Trustee. The order denying the petition for rehearing by the Circuit Court of Appeals is set forth at pages 49a to 51a of the appendix to the Petition filed by the Trustee. The order of the United States Bankruptcy Court for the District of New Jersey authorizing abandonment of the New Jersey property is set forth at pages 64a to 65a of the appendix to the Petition filed by the Trustee.

The opinion of the Third Circuit Court of Appeals in the companion case of *City of New York* v. *Quanta Resources Corp. (In the Matter of Quanta Resources Corporation, Debtor)*, is reported at 739 F.2d 912. This opinion is also set forth at pages 1a to 43a of the appendix to the Petition filed by the Trustee. The opinion of the United States District Court for the District of New Jersey in the companion case is not reported but is set forth at pages 52a to 60a of the appendix to the Petition filed by the Trustee. The opinion of the United States Bankruptcy Court for the District of New Jersey in the companion case is not reported but is set forth at pages 69a to 75a of the appendix to the Petition filed by the Trustee.

Jurisdiction

Midlantic National Bank ("Midlantic") and the Trustee have invoked jurisdiction of the Court under 28 U.S.C. §1254(1). The judgments of the Court of Appeals in Case

No. 83-5154 and in Case No. 83-5730 were entered on July 20, 1984. On August 16, 1984, the Court of Appeals denied rehearing.

Constitutional Provisions and Statutes

The Supremacy Clause of Article 6 and the Fifth Amendment to the United States Constitution along with three federal statutes, 11 U.S.C. §554(a), 11 U.S.C. §704, and 28 U.S.C. §959(b), are central to this matter.

Article VI, Clause 2:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution of Laws of any State to the Contrary notwithstanding.

Amendment V:

> No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

11 U.S.C. §554(a):

After notice and a hearing the trustee may abandon any property of the estate that is burdensome to the estate or that is of inconsequential value to the estate.

11 U.S.C. §704:

The trustee shall—

(1) collect and reduce to money the property of the estate for which such trustee serves, and close such estate as expeditiously as is compatible with the best interests of parties in interest;

(2) be accountable for all property received;

(3) ensure that the debtor shall perform his intention as specified in section 521(2)(B) of this title;

(4) investigate the financial affiairs of the debtor;

(5) if a purpose would be served, examine proofs of claims and object to the allowance of any claim that is improper;

(6) if advisable, oppose the discharge of the debtor;

(7) unless the court orders otherwise, furnish such information concerning the estate and the estate's administration as is requested by a party in interest;

(8) if the business of the debtor is authorized to be operated, file with the court and with any governmental unit charged with responsibility for collection or determination of any tax arising out of such operation, periodic reports and summaries of the operation of such business, including a statement

of receipts and disbursements, and such other information as the court requires; and

(9) make a final report and file a final account of the administration of the estate with the court.

28 U.S.C. §959(b):

Except as provided in section 1166 of title 11, a trustee, receiver or manager appointed in any cause pending in any court of the United States, including a debtor in possession, shall manage and operate the property in his possession as such trustee, receiver or manager according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof.

Statement of the Case

These two companion cases, arising out of the same bankruptcy proceeding, present to the Court the question of the construction of the abandonment provision of the Bankruptcy Code, 11 U.S.C. §554, and the interrelationship of that statutory provision with other state and federal laws. The question arises in the context of a bankruptcy liquidation involving a debtor which had conducted waste oil recycling operations in Edgewater, New Jersey, and Long Island City, New York.[1] Abandonment of the two sites by the Trustee is opposed by the environmental agencies of

[1] Insofar as Midlantic's security interest in certain property of the debtor does not extend to the Long Island City facility, Midlantic will rely upon the Trustee to set forth the specific facts concerning abandonment of that facility.

New York and New Jersey who seek to compel the Trustee to bring the sites into compliance with all environmental laws.

Quanta Resources Corporation ("Quanta") was formed as a Delaware corporation in March 1980.[2] In July 1980, Quanta entered in an agreement to acquire Edgewater Terminals, Inc., and its interest in a lease for property located at 1 River Road, Edgewater, New Jersey (R. Stip. ¶6). Through this agreement, a Temporary Operating Authorization ("TOA") from the New Jersey Department of Environmental Protection ("NJDEP") to operate a waste oil recovery business at the Edgewater site was assigned to Quanta (R. Stip. ¶¶4, 7).

With the TOA in hand, Quanta accepted waste oil and oil sludge at the Edgewater property in order to process the oil for resale (R. Stip. ¶7). On June 3, 1981, Quanta borrowed $600,000.00 from Midlantic for working capital and executed a Note and Security Agreement (R. Stip. ¶9). Midlantic's security interest in Quanta's inventory, accounts receivable and several items of equipment was duly perfected pursuant to New Jersey law (R. Stip. ¶9).[3] By Order dated April 5, 1982, the United States Bankruptcy Court for the District of New Jersey determined that Midlantic holds a valid first priority lien in the sum of $643,-

[2] Paragraph 5 of the Stipulation of Facts filed on December 20, 1982, in *Frola* v. *O'Neill* (*In re Quanta Resources Corporation*), Case No. 81-05967, Adversary No. 82-0753 (Bkrtcy. D.N.J.) designated as item seven in the Designation of Contents for Inclusion in Record on Appeal. For ease of reference, subsequent citations will be made according to the following form—R. Stip. ¶5.

[3] Midlantic's security interest did not extend to any of Quanta's Long Island City property.

660.68 in the various item of the debtor's Edgewater property including the waste oil inventory relevant to this application (R. Stip. ¶11).

Late in June 1981, NJDEP sample waste oil stored by Quanta at the Edgewater site and discovered unlawful concentrations of polychlorinated biphenyls ("PCBs") (R. Stip. ¶8). Under the terms of the TOA, PCBs could not be stored at the faciilty (R. Stip. ¶8). As a result, on July 2, 1981, Quanta complied with a NJDEP request and ceased all operations at the Edgewater site (R. Stip. ¶10).

On October 6, 1981, Quanta filed a voluntary petition for reorganization under Chapter 11 of the Bankruptcy Code (R. Stip. ¶1). The Chapter 11 petition was converted to a Chapter 7 liquidation proceeding on November 18, 1981 and on that same day Thomas J. O'Neill was designated as the Quanta trustee (R. Stip. ¶2).

The Trustee proceeded to sell a portion of the waste oil inventory that was not contaminated with PCBs, generating a sum of approximately $288,000.00 (R. Stip. ¶12).[4]

[4] On July 7, 1982, the owners of the Edgewater property, Frola and Von Dohlin, started an action in the Bankruptcy Court seeking, *inter alia*, an order directing the Trustee to turn over the proceeds of the sale of this oil to the landowners. *Frola* v. *O'Neill* (*In re Quanta Resources Corporation*), Case No. 81-05967, Adversary No. 82-0753(Bkrtcy. D.N.J.) NJDEP cross-claimed seeking the funds for future cleanup of the site. By order of April 27, 1983, the Bankruptcy Court dismissed the claim of the landowners and the NJDEP and deferred resolution of Midlantic's turnover application as being premature. The NJDEP appeal to the District Court from this order is now pending although on "administrative hold" until the abandonment issue is resloved. *Frola* v. *O'Neill* (*In re Quanta Resources Corporation*), Civil Action No. 83-4358 (D.N.J.). Pursuant to a consent order, the Trustee has distributed the proceeds to various parties subject to further adjudication of NJDEP's rights.

In addition, through notices issued on October 8, 1982, October 18, 1982, and April 22, 1983, the Trustee announced his intention to abandon the PCB laden waste oil inventory in Edgewater (R. Stip. ¶19; R. October 8, 1982, Notice; R. October 18, 1982, Revised Notice; R. April 22, 1983, Notice). Over NJDEP objections of October 14, 1982, and April 27, 1983, the Bankruptcy Court authorized abandonment of the Edgewater site by order of May 20, 1983[5] (R. May 20, 1983, Order reprinted at Appendix I to the Trustee's Petition for Certiorari).

Since the abandonment issued raised in the New Jersey case was already pending before the Court of Appeals for the Third Circuit, a notice of appeal by agreement to the Court of Appeals under 28 U.S.C. §1293(b) was filed by NJDEP on September 21, 1983 (R. Notice of Appeal). It is important to note that in the appeal NJDEP did not challenge the conclusion of the Bankruptcy Court that the Edgewater facility and its contaminated waste oil inventory were of no value and were instead a great burden to the estate. Instead, NJDEP argued that the Trustee could not abandon the burdensome property because of a duty to clean up the environmental contamination arising under police power laws of the State of New Jersey (R. Statement of Issue on Appeal).

Over the dissent of Circuit Judge Gibbons, the Third Circuit Court of Appeals reversed the decision of the Bank-

[5] The United States Bankruptcy Court for the District of New Jersey had jurisdiction over the abandonment application under §405 of the Bankruptcy Reform Act of 1978, Pub. L. 95-598, Title IV, 92 Stat. 2686 (1978), *reprinted in note preceding,* 28 U.S.C.A. §1471 (West Supp. 1983) and Local Rule 47 of the United States District Court for the District of New Jersey that was issued on October 1, 1982.

ruptcy Court holding that the Trustee would violate state environmental legislation if he were to abandon the contaminated oil and that the Trustee must somehow bring the Edgewater site into compliance with local environmental laws.

Summary of Argument

1. The Court of Appeals violated a canon of statutory construction in interpreting the abandonment provision of the Bankruptcy Code, 11 U.S.C. §554(a), so as to raise a substantial constitutional issue of taking under the Fifth Amendment to the United States Constitution. *United States* v. *Security Industrial Bank,* 459 U.S. 70, 103 S.Ct. 401, 74 L.Ed.2d 235 (1982). The Fifth Amendment commands that the burden of cleaning up environmental problems of a valueless asset abandoned by a trustee in bankruptcy be borne by the general public and not the creditors of the debtor's estate. *Louisville Joint Stock Land Bank* v. *Radford,* 295 U.S. 555, 55 S.Ct. 854, 79 L.Ed. 1593 (1935).

2. Congress did not intend that abandonment of burdensome and valueless assets of an estate being liquidated in bankruptcy be conditioned upon a trustee first spending assets that would otherwise go to creditors so as to bring the abandoned property into compliance with state environmental laws.

(a) Abandonment of a burdensome asset does not constitute an act or omission triggering liability for a trustee under environmental laws. *Brown* v. *O'Keefe,* 300 U.S. 598, 57 S.Ct. 543, 81 L.Ed. 827 (1937).

(b) Public policy demands that trustees serving under federal bankruptcy law not assume personal responsibility

for environmental problems arising through prepetition conduct of debtors.

(c) The Court of Appeals erred in creating a limitation upon a trustee's ability to abandon burdensome estate assets in view of the clear and conclusive language of 11 U.S.C. §554(a). *United States* v. *Clark,* 454 U.S. 555, 102 S.Ct. 895, 70 L.Ed.2d 768 (1982). *Ohio* v. *Kovacs,* —— U.S. ——, 105 S.Ct. 705, 83 L.Ed.2d 649 (1985).

3. Insofar as they impact upon 11 U.S.C. §554(a) and a trustee's ability to abandon burdensome property, state environmental laws stand as an obstacle to the purposes and objectives of Congress and fall under the supremacy clause. *Perez* v. *Campbell,* 402 U.S. 637, 91 S.Ct. 1704, 29 L.Ed.2d 233; *Hines* v. *Davidowitz,* 312 U.S. 52, 61 S.Ct. 399, 85 L.Ed. 581 (1941).

ARGUMENT

POINT I

The interpretation given to 11 U.S.C. §554(a) by the Court of Appeals raises a substantial question under the taking clause of the Fifth Amendment and therefore conflicts with the rule of statutory construction confirmed in *United States* v. *Security Industrial Bank*, 459 U.S. 70, 103 S.Ct. 407, 74 L.Ed.2d 235 (1982).

As a creditor with a perfected security interest in the fund created from the sale of a portion of Quanta's waste oil inventory, Midlantic has raised its voice on its own and on behalf of all creditors against the far reaching interpretation given to 11 U.S.C. §554(a) by the Court of Appeals. Under the decision below, who must bear the huge cost of disposing of the PCB contaminated oil?[6] No party has ever challenged the fact that the Trustee has never had sufficient funds to clean up either site. Nonetheless, the Court of Appeals reversed the Bankruptcy Court orders authorizing abandonment directing that the environmental cleanup costs be evaluated as administrative expenses on remand. *City of New York* v. *Quanta Resources Corp. (In re Quanta Resources Corp.),* 739 F.2d 912, 923 (3d Cir. 1984); *In re Quanta Resources Corporation,* 739 F.2d 927, 929 (3d Cir. 1984).[7] Through this command, the

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[6] Following abandonment of the Long Island City property by the Trustee, New York City and New York State cleaned up that site at an expense of approximately $2,500,000.00 (Petition of Trustee, p. 5, footnote 2). To date NJDEP has not taken any action to clean up the Edgewater site.

[7] In his dissent in the New York case, Circuit Judge Gibbons criticized the majority's sidestep of the administrative expense

(Footnote continued on following page)

Court of Appeals has shifted the burden of environment compliance from the debtor to the Trustee to the creditors, possibly including secured creditors such as Midlantic, "who, on the record before us, were in no way responsible for placing the contaminated oil on that site". *Id.* at 925 (dissent of Judge Gibbons).

Midlantic respectfully asserts that the Court of Appeals violated a canon of statutory construction in its drive to advance the important policy of protecting the public health by regulating disposal of toxic wastes. *See, City of New York* v. *Quanta Resources Corp.,* 739 F.2d at 921. Throughout this litigation, both Midlantic and the Trustee have argued that a rule conditioning the clear command of the abandonment provision of the Bankruptcy Code, 11 U.S.C. §554(a), would raise a serious taking issue under the Fifth Amendment. Yet, the Court of Appeals saw no taking question arising under the Fifth Amendment in the destruction of Midlantic's rights as a secured creditor in favor of the public welfare. Indeed, the constitutional argument was dismissed in a footnote. *City of New York* v. *Quanta Resources Corp.,* 739 F.2d at 922 (footnote 11). This casual dismissal of the taking issue completely disregarded the rationale of this Court in *United States* v. *Security Industrial Bank,* 459 U.S. 70, 103 S.Ct. 401, 74 L.Ed.2d 235 (1982).

(Footnote continued from preceding page)

priority issue as irresponsible. *City of New York* v. *Quanta Resources Corp.,* 739 F.2d at 925. Expanding the Third Circuit Quanta opinions, one Bankruptcy Court has recently held that environmental claims are administrative expenses under 11 U.S.C. §503 and are entitled to priority over all unsecured creditors under 11 U.S.C. §507(a)(1). *In re T.P. Long Chemical, Inc.,* 45 B.R. 278, 286-290 (Bkrtcy. N.D. Ohio 1985).

In *Security Industrial Bank,* a secured creditor challenged retrospective application of §522(f)(2) of the Bankruptcy Code, 11 U.S.C. §522(f)(2), as an unconstitutional taking of a pre-enactement lien under the Fifth Amendment. On review, this Court first noted that under *Louisville Joint Stock Land Bank* v. *Radford,* 295 U.S. 555, 55 S.Ct. 854, 79 L.Ed. 1593 (1935) the bankruptcy power is subject to the Fifth Amendment's prohibition against taking private property without compensation. 459 U.S. at 75, 103 S.Ct. at 410, 74 L.Ed.2d at 240. The *Security Industrial Bank* Court next reviewed the nature of the claimed taking and found that the government action would result in a complete destruction of the property right of the secured party. 459 U.S. at 75, 103 S.Ct. at 411, 74 L.Ed. 2d 241. To avoid this grave constitutional question, the Court applied the cardinal principle of statutory construction that a statute should be construed so as to avoid a constitutional question if an alternative interpretation is fairly possible. *Security Industrial Bank,* 459 U.S. at 78, 103 S.Ct. at 412, 74 L.Ed.2d at 243. Stated alternatively:

> As a corollary of the presumption favoring constitutionality, the fact that one among alternative constructions would involve serious constitutional difficulties is reason to reject that interpretation in favor of another.

2A N.J. Singer, *Sutherland Statutory Construction,* §45.11 (Sands 4th Ed. 1984).

As in *Security National Bank,* the interpretation given to 11 U.S.C. §554(a) by the Court of Appeals creates a very serious question of an unconstitutional taking of private property under the Fifth Amendment. Indeed, in footnote eleven of the Long Island City abandonment opinion, the Third Circuit concluded that it would be constitutionally reasonable to require that proceeds normally

targeted for satisfaction of a secured creditor's lien be instead spent by the Trustee to comply with toxic waste disposal. 739 F.2d at 922.[8] The end result would be total destruction of Midlantic's lien since, even including the money that would be otherwise paid to Midlantic, the Trustee only has a small fraction of the funds necessary to compensate the New York regulatory agencies for cleanup of the Long Island City site.

In dismissing the taking issue, the Court of Appeals categorized enforcement of New York and New Jersey environmental laws as a permissible regulatory activity and not an unconstitutional taking. 739 F.2d at 922 (footnote 11). Midlantic respectfully disagrees. Starting with *Village of Euclid* v. *Ambler Realty Co.,* 272 U.S. 365, 47 S.Ct. 114, 71 L.Ed. 303 (1926) (zoning ordinance limiting use of property valid as exercise of police power) through *Agins* v. *City of Tiburon,* 447 U.S. 255, 100 S.Ct. 2138, 65 L.Ed.2d 106 (1980) (zoning ordinance placing land in residential planned development and open space zone), this Court has repeatedly recognized that reasonable regulatory actions do not constitute unlawful takings. However, reasonableness has its limits and at some point in time regulation crosses the line to become confiscation. As noted by Justice Brandeis in the *Louisville Joint Stock Land Bank* v. *Radford* opinion:

> [T]he Fifth Amendment commands that, however great the Nation's need, private property shall not be thus taken even for a wholly public use without just compensation. If the public interest requires, and permits, the taking of property of individual mortgages in order to relieve the necessities of individual mortgagors, resort must be had to proceedings by eminent domain; so that, through taxation, the burden of the relief afforded in the public interest may be borne by the public.

295 U.S. at 602.

[8] This conclusion conflicts with the recent decisions of the Bankruptcy Court for the Northern District of Ohio In *In re T.P. Long Chemical, Inc.,* 45 B.R. 278 (Bkrtcy. N.D. Ohio 1985). Nonetheless, absent reversal by this Court, the New Jersey Bankruptcy Court will probably be persuaded by the reasoning of the Third Circuit on remand.

Since implementation of the Third Circuit decisions in the two *Quanta* cases will undoubtedly lead to total destruction of Midlantic's property interest, reliance upon the cases upholding limited regulatory activities stands completely off the mark. The result is not regulation but destruction. Moreover, the effect falls upon an innocent third party and not a primary actor somehow responsible for the necessity of the regulatory action. On these facts the Court of Appeals erred in finding that its construction of 11 U.S.C. §554(a) did not raise a substantial question under the taking clause of the Fifth Amendment.

Once such a question was raised, the holding of this Court in *United States* v. *Security Industrial Bank,* 479 U.S. 70, 103 S.Ct. 407, 74 L.Ed. 2d (1982) required that the Court of Appeals ascertain whether another construction of 11 U.S.C. §554(a) would avoid the constitutional question. 459 U.S. at 78, 103 S.Ct. at 412, 74 L.Ed. 2d at 243; *see also, Lorillard* v. *Pons,* 434 U.S. 575, 577, 98 S.Ct. 866, 868 55 L.Ed.2d 40 (1978). A construction that would not condition abandonment upon environmental compliance would certainly avoid the taking issue. Moreover, as demonstrated through Point II of this Brief, any alternative construction would flatly contradict the intention of Congress in enacting §554(a).

POINT II

Abandonment of burdensome and worthless property pursuant to 11 U.S.C. §554(a) by a trustee serving in a liquidation proceeding under Chapter 7 of the Bankruptcy Code is not conditioned upon compliance with local police power regulations.

A. The Court of Appeals seriously misconstrued §554(a) of the Bankruptcy Code in holding that a trustee would violate environmental protection laws by abandoning contaminated property.

In the two decisions below, the Court of Appeals held that the Trustee could not abandon burdensome property because abandonment would contravene state and local environmental laws. *City of New York* v. *Quanta Resources Corp.,* 739 F.2d at 913; *In re Quanta Resources Corporation,* 739 F.2d at 928-929. Midlantic asserts that one reason why these holdings are wrong is that the Court of Appeals misconstrued the basic issue on appeal. The true issue being whether abandonment may be conditioned upon compliance with state and local environmental laws instead of whether the Trustee would actually violate such laws upon abandonment. A brief review of the history of a trustee's abandonment power shows why the phrasing of this issue is so important.

Prior to 1978, the law of bankruptcy was governed by the Bankruptcy Act of 1898. The Bankruptcy Act did not contain a specific statutory provision governing abandonment of property in the liquidation context. *See, Ottenheimer* v. *Whitaker,* 198 F.2d 289, 290 (4th Cir. 1952), *affirming,* 102 F. Supp. 103 (D.Md. 1952) and 4 L.P. King, *Collier on Bankruptcy,* ¶554.01 (15th Ed. 1985). Instead, case law permitted a trustee to abandon valueless property so as to further the paramount purpose of liquidation—

the reduction of the debtor's property to money for expeditious distribution to general creditors. 4 L.P. King, *Collier on Bankruptcy,* ¶554.01 (15th Ed. 1985). The common law rule has now been replaced by a specific statutory provision governing abandonment—11 U.S.C. §554(a).

In addition, title to property of the debtor's estate was treated differently under the prior Bankruptcy Act.

> Former section 70a of the Act vested title to the debtor's property in the trustee. Abandonment then divested the trustee of this title and revested it in the debtor. Under Section 541 (11 U.S.C. §541), the Trustee no longer takes title to the debtor's property, and, upon abandonment under Section 554, the trustee is simply divested of control of the property because it is no longer part of the estate. Thus, abandonment constitutes a divesture of all interests in the property that were property of the estate.

4 L.P. King, *Collier on Bankruptcy,* ¶554.02(2) (15th Ed. 1985). However, even under the prior act, title to property abandoned by a trustee revested in the debtor as of the date of commencement of the bankruptcy proceeding. *Brown* v. *O'Keefe,* 300 U.S. 598, 602, 57 S.Ct. 543, 81 L.Ed. 827 (1937). This "legal fiction" continues under applicataion of §554(a). *Mason* v. *C.I.R.,* 646 F.2d 1309, 1310 (9th Cir. 1980); *In re Cruseturner,* 8 B.R. 581, 591-592 (Bkrtcy. D.Utah 1981). The analysis of Bankruptcy Judge Mabey in the *Cruseturner* opinion is particularly relevant.

> Thus, when the trustee abandons property, the property stands as if no bankruptcy had been filed and the debtor enjoys the same claim to it and interest in it as he held previous to the filing of bankruptcy . . . Although case law characterization of the revesting of property in the debtor has been

> referred to as "legal fiction" . . . application in this context is appropriate in light of both the legislative history and the plain meaning of the applicable statutory provisions.

In re Cruseturner, 8 B.R. at 591-592.

By operation of the "legal fiction" as to title of abandonment property, the Quanta Trustee would stand as if he never had any interest in the polluted inventories. He would therefore be immune from prosecution for violation of environmental laws, subject to liability only if he undertook some prohibited act such as pouring the waste oil down a sanitary sewer.

Sound policy considerations support continuation of the "legal fiction" surrounding abandonment in a bankruptcy liquidation proceeding in today's world. Midlantic asks, who would choose to serve as a trustee in bankruptcy if personal liability would attach to such a trustee for environmental problems arising because of prepetition conduct of the debtor? Indeed, in its opinion concerning the Long Island City abandonment, the Court of Appeals indicated that by abandoning the contaminated waste oil the Trustee may be guilty of a felony under New York law. *City of New York* v. *Quanta Resources Corp.,* 739 F.2d at 921. Clearly, no person would accept such a perilous responsibility and the bankruptcy system would grind to a halt in any case where potential environmental issues could arise.

This exact problem surface in *In re Charles George Land Reclamation Trust,* 30 B.R. 918 (Bkrtcy. Ma. 1983). In that case, no person was willing to accept the risk of personal liability arising under state and federal environmental laws by serving as a Chapter 7 trustee for an estate with grave environmental problems. *Id.* at 924. As

a result, the Bankruptcy Court dismissed the Chapter 7 proceeding citing as reasons the lack of resources, expertise and a qualified trustee. *Id.* This abdication of responsibility is the end product of an irrational interpretation of 11 U.S.C. §554(a). This Court should address this very important issue with a clear and direct statement limiting liability of a trustee under the doctrine of *Brown* v. *O'Keefe,* 300 U.S. 598, 602, 57 S.Ct. 543, 81 L.Ed. 827 (1937).

B. The Court of Appeals erred in concluding that Congress intended that abandonment be conditioned upon compliance with state environmental protection laws.

The starting point in statutory interpretation is the language of the statute—in this case 11 U.S.C. §554(a). *Reiter* v. *Sonotone Corp.,* 442 U.S. 330, 337, 99 SCt. 2326, 2330, 60 L.Ed.2d 931 (1978). If the statutory language is clear, it is ordinarily conclusive. *United States* v. *Clark,* 454 U.S. 555, 561, 102 S.Ct. 895, 809, 70 L.Ed.2d 768 (1982). It is not a function of the United States Supreme Court or any other court to sit as a super-legislature and create statutory distinctions where none was intended. *American Tobacco Co.* v. *Patterson,* 456 U.S. 63, 72, 102 S.Ct. 1534, 1539, 71 L.Ed.2d 748 (1982) (footnote 6), *citing, Griswald* v. *Connecticut,* 381 U.S. 479, 482, 85 S.Ct. 1678, 1680, 14 L.Ed.2d 510 (1965). Absent a clearly expressed legislative intention to the contrary, the statutory language must be regarded as conclusive by a reviewing court. *Consumer Product Safety Comm'n* v. *GTE Sylvania, Inc.,* 447 U.S. 102, 108, 100 S.Ct. 2051, 2055, 64 L.Ed.2d 766 (1980).

In construing 11 U.S.C. §554(a), the Court of Appeals found clear language which on its face did not condition abandonment upon compliance with state environmental

legislation. It then noted that there is no specific legislative history of §554(a). *City of New York* v. *Quanta Resources Corp.*, 739 F.2d at 916. Nonetheless, the Court of Appeals searched long and hard to find what it determined to be a legislative intent to condition abandonment upon compliance with local environmental laws. Midlantic respectfully asserts that the Court of Appeals erred by looking beyond the express language of §554(a) to create a statutory distinction that was not intended by Congress.

The Third Circuit first examined several cases decided prior to enactment of the statutory abandonment provision which held that a trustee's ability to abandon burdensome property is subject to police power regulations. The first case was *Ottenheimer* v. *Whitaker,* 198 F.2d 289 (4th Cir. 1952), *aff'g,* 102 F.Supp. 193 (D.Md. 1952). In *Ottenheimer,* the Court of Appeals held that trustee could not abandon a number of dilapidated barges in Baltimore harbor when abandonment would violate a federal statute prohibiting the sinking of vessels in a navigable channel. *Id.* at 290. The absence of a statutory provision governing abandonment weighed heavily in the balancing analysis undertaken by the Fourth Circuit.

> It seems obvious to us that a rule which is not provided by statute but built up by the courts to facilitate the administration and distribution of the assets of a bankrupt estate should not be extended so as to reach such an unreasonable and unjust result. The judge-made rule must give way when it comes in conflict with a statute enacted to ensure the safety of navigation . . .

Id. at 290. As a result, it stands clear that the analysis of the *Ottenheimer* Court would have markedly differed if 11 U.S.C. §554(a) had been in effect at the time of that trustee's application for abandonment.

The second case relied upon by the Third Circuit in *Quanta* was *In re Lewis Jones, Inc.*, 1 Bkr.Ct. Dec. 277 (Bkrtcy. E.D.Pa. 1974). In that case, a trustee of a public utility was barred from abandoning underground steampipes and vents when abandonment would expose the public to risk of accident and injury. The *Lewis Jones* Court heavily relied upon the *Ottenheimer* case in reaching this decision and, in fact, did not cite to any other case in support of the principle that the power to abandon is subject to police power regulations. Therefore, it must also be conceded that the analysis of the *Lewis Jones* Court would also dramatically change if §554 had been enacted prior to the time of that decision.

Moreover, *Lewis Jones* is also distinguishable because of the particular equitable considerations present in that case. In *Lewis Jones,* it was estimated that the trustee could adequately protect the public safety by sealing the underground pipes at a cost of approximately $64,000. *In re Lewis Jones,* 1 Bkr. Ct. Dec. at 278-279. Insofar as the bankruptcy estate contained over $325,000, the *Lewis Jones* Court determined that an expenditure of $64,000 would not be unreasonable. *Id.* at 280. In contrast, the Quanta estate does not contain sufficient funds for cleanup of either the Edgewater or Long Island City facilities. There would be no "cushion" for creditors if the Trustee had to clean up the property prior to abandonment. As a result, the Court of Appeals erred in relying upon the particular equitable considerations so important to the decision of the *Lewis Jones* Court.

The Third Circuit also looked to *In re Chicago Rapid Transit Co.*, 129 F.2d 1 (7th Cir. 1942), *cert. denied,* 317 U.S. 683, 63 S.Ct. 205, 87 L.Ed. 547 (1942), for guidance on the legislative intent issue. There, the Seventh Circuit determined that trustees for a railroad in reorganition could not abandon services on a branch line absent

approval of local regulatory authorities. *Id.* at 5. Two factors distinguish *Chicago Rapid Transit* from the case at bar. First, the debtor was in reorganization rather than in liquidation. Second, the abandonment directly related to operation and management of the debtor's business as opposed to the situation in Quanta where the Trustee was attempting to fulfill his statutory directive to wrap up the estate.[10]

As noted by Judge Gibbons in his dissenting opinion below, not one of the above-referred decisions is persuasive under the Bankruptcy Reform Act of 1978. Focusing upon *Ottenheimer* and *Lewis Jones,* Judge Gibbons commented that:

> Neither of these opinions, however, is persuasive under the 1978 Bankruptcy Reform Act. Both substitute slogans about equity for an analysis of the purpose of bankruptcy proceedings. Both, moreover, were decided prior to the enactment of the Bankruptcy Reform Act of 1978, and its codification in 11 U.S.C. §554 (1982) of the express authority for trustees to decline to undertake responsibility for property which cannot benefit the estate. Thus there was no statutory provision permitting trustees to abandon burdensome property at the time of those decisions. Such an express statutory provision now exists. Moreover, Congress did *not* see fit to provide an exception to this statutory power, whether for the public interest or any other purpose, as it has in other areas. *Compare* 11 U.S.C. §362(a) (1982) (exception to automatic stay); *Penn Terra Ltd.* v. *Department of Environmental Re-*

[10] The requirement that a trustee manage and operate property in a reorganization proceeding in accordance with the state law has since been codified at 28 U.S.C. §959(b).

> *sources,* 733 F.2d 267, 274-79 (3d Cir. 1984) (injunction to enforce compliance with state laws is not a money judgment, and is therefore not subject to §362 stay) with 11 U.S.C. §554 (1982). Thus *Ottenheimer* and *Lewis Jones* are not helpful.

City of New York v. *Quanta Resources Corp.,* 739 F.2d at 923-924. Thus, the *Quanta* majority's reliance upon these older cases stands misplaced in view of the changes to the bankruptcy laws that were enacted in 1978.

The comparison drawn by Judge Gibbson in his dissent between §554(a) and other statutory provisions further demonstrates that Congress did not intend for abandonment to be conditioned upon environmental compliance. The regulatory exception to the automatic stay provision of 11 U.S.C. §362 was noted by this Court in *Ohio* v. *Kovacs,* —— U.S. ——, 105 S.Ct. 705, 711, 83 L.Ed. 2d 649 (1985). In §362 of the Bankruptcy Code, Congress created a specific exception to the general rule that commencement or continuation of actions against a debtor in bankruptcy are automatically stayed. If Congress intended that a similar exception apply to abandonment under §554(a), specific language would have also been incorporated.

That conclusion is buttressed by reference to 28 U.S.C. §959(b) which requires a trustee or receiver appointed by any United States Court to manage and operate property in his possession in accordance with state law. Yet, as noted in a prominent treatise, this duty does not extend to a trustee who is liquidating estate assets as opposed to carrying on the business of a debtor.

> But Section 959(b) applies only to the Receiver in his operation of property in his possession. It does not apply to the distribution of the estate,

> and does not require the federal receivership court to comply with state laws regulating the distribution of funds in the receivership . . .

7-Pt. 2 J. Moore and J. Lucas, *Moore's Federal Practice* §66.04(4) at 1913 (2d Ed. 1982); *see also, Austrian* v. *Williams,* 216 F.2d 278, 285 (2d Cir. 1954), *cert. denied,* 348 U.S. 953, 75 S.Ct. 441, 99 L.Ed. 745 (1954) (holding that the mere collection and liquidation of assets did not constitute the carrying on of a debtor's business).

Additional support is found in the decision of the Eighth Circuit Court of Appeals in *State of Mo.* v. *U.S. Bkrtcy. Court, Etc.,* 647 F.2d 768 (8th Cir. 1981), *cert. denied,* 454 U.S. 1162, 102 S.Ct. 1035, 71 L.Ed. 2d 318 (1982). In that case, the State of Missouri contended that a Chapter 11 trustee planned to operate a grain warehouse without a state license in violation of 28 U.S.C. §959(b). Writing for the Circuit Court, Judge Bright recognized that, in operations, the trustee must act consistent with the dictates of §959(b). *Id* at 778. However, Judge Bright went on to note that:

> We add that any authorized action by the trustee to liquidate or sell the grain appears to fall within the power of the bankruptcy court to liquidate the debtors' assets under the Bankruptcy Act. We doubt, therefore, that a trustee must obtain a state license solely for liquidation.

Id., note 18. Similarly, NJDEP cannot here demand that the Quanta Trustee bring the Edgewater facility into full environmental compliance when the Trustee's role is limited to the liquidation of estate assets.

Based upon a review of every authority relied upon by the Court of Appeals, one must conclude that Congress

did not intend that the Trustee's power to abandon worthless property under §554(a) be limited by environmental regulations. As noted by this Court in footnote 12 of the *Kovacs* opinion:

> Had no receiver been appointed prior to Kovacs' bankruptcy, the trustee would have been charged with the duty of collecting Kovacs' nonexempt property and administering it. If the site at issue were Kovacs' property, the trustee would shortly determine whether it was of value to the estate. If the property was worth more than the costs of bringing it into compliance with state law, the trustee would undoubtedly sell it for its net value, and the buyer would clean up the property, in which event whatever obligation Kovacs might have had to clean up the property would have been satisfied. If the property were worth less than the cost of cleanup, the trustee would likely abandon it to its prior owner, who would have to comply with the state environmental law to the extent of his or its ability.

Ohio v. *Kovacs,* 105 S.Ct. at 711.

By focusing upon the important policy of protecting the public health by regulating the disposal of toxic wastes, the Court of Appeals forged an exception to the abandonment statute that is not supported at law. The decisions represent an impermissible intrusion into the legislative arena and should be reversed.

Moreover, existing law contains adequate measures to protect the public safety.[11] Under N.J.S.A. 58:10-23.11f(f)

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[11] In addition, in this case, abandonment would in all likelihood vest title to the oil in Quanta's landlords, Frola and Von Dohlin, who would remediate the contamination so as to render their land once again valuable.

(West Supp. 1983), NJDEP could have cleaned up the Edgewater site and claimed a "first priority claim and lien paramount to all other claims and liens" on the Quanta property. Since NJDEP failed to take any action to clean up the Edgewater property and thus trigger a priority claim to Quanta assets, this Court should not endorse the decision of the Third Circuit to condition abandonment of the contaminated oil upon compliance at the expense of secured creditors such as Midlantic.

POINT III

Conditioning abandonment of burdensome property upon environmental compliance frustrates full effectuation of the objectives of federal bankruptcy legislation and therefore violates the supremacy clause.

The Court of Appeals' construction of 11 U.S.C. §554(a) also raises a serious question of Constitutional law arising under the supremacy clause, U.S. Const. Art. VI, cl. 2. Specifically, that question is whether state environmental laws upon which abandonment of burdensome assets in a liquidation proceeding would be conditioned are invalid insofar as they "stand as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *See, Michigan Canners & Freezers Assn.* v. *Agricultural Marketing and Bargaining Board,* —— U.S. ——, 104 S.Ct. 2518, 2523, 81 L.Ed.2d 399, 406 (1984); *Hines* v. *Davidowitz,* 312 U.S. 52, 67, 61 S.Ct. 399, 85 L.Ed. 581 (1941). As in *Perez* v. *Campbell,* 402 U.S. 637, 91 S.Ct. 1704, 29 L.Ed.2d 233 (1971), the supremacy clause analysis focuses upon the objectives of federal bankruptcy legislation.

In page after page of involved analysis, the Court of Appeals in Quanta wrestled with the supremacy clause

issue. *City of New York* v. *Quanta Resources Corp.,* 739 F.2d 915-922. Applying the two-step test set forth in *Perez* v. *Campbell,* 402 U.S. at 644, 91 S.Ct. at 1708-1711, 29 L.Ed. 2d at 239, the Third Circuit first examined the purposes of the laws at issue and then determined whether the state environmental laws frustrated the objectives of the Bankruptcy Code. *City of New York* v. *Quanta Resources Corp.,* 739 F.2d at 915. Midlantic respectfully asserts that the Court of Appeals erred in concluding that the state laws do not frustrate the principal duty of a trustee under 11 U.S.C. §704 to collect and reduce to money the property of the estate and to close the estate in an expeditious manner.[12]

Midlantic would offer one specific example to properly focus the attention of the Court on the supremacy issue. In 1983, the New Jersey Legislature enacted the Environmental Cleanup Responsibility Act ("ECRA"), N.J.S.A. 13:1K-6 *et seq.* (West Supp. 1984). Through ECRA, an owner or operator of certain industrial establishments is required to notify NJDEP in advance of a decision to stop, sell or transfer operations. N.J.S.A. 13:1K-9(a)(1) and (b(1) (West Supp. 1984). ECRA also requires preparation of cleanup plans to correct environmental problems along with submission of surety bonds to guarantee cleanup. N.J.S.A. 13:1K-9(a)(2) and (b)(3) (West Supp. 1984). Failure to comply with any provision of ECRA triggers (1) voiding of the transfer, (2) strict liability for cleanup costs and (3) substantial civil penalties. N.J.S.A. 13:1K-13 (West Supp. 1984).

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[12] *See,* S. Rep. No. 95-989, 95th Cong., 2d Sess. 93 (1978), *reprinted in* (1978) U.S. Code Cong. & Ad. News 5787, 5879 and H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 379 (1977), reprinted in, (1978) U.S. Code Cong. & Ad. News 5963, 6335.

Under the decisions below, the Quanta Trustee must not abandon the Edgewater, New Jersey property but must instead bring the site into environmental compliance. Although N.J.S.A. 13:1K-8(b) (West Supp. 1984) excepts the *initiation* of bankruptcy proceedings from ECRA responsibilities, it will undoubtedly be argued that subsequent action by the Trustee must conform to ECRA standards. Thus, the Trustee must post bonds, draft cleanup plans and look not to the Bankrutpcy Court but instead to NJDEP for ratification of decisions central to estate administration. NJDEP would thereby usurp the power of the Bankruptcy Court in violation of the supremacy clause.

Morever, Section 8 of ECRA, N.J.S.A. 13:1K-12 (West Supp. 1984), provides that "(n)o obligations imposed by this act shall constitute a lien or claim which may be limited or discharged in a bankruptcy proceeding." Thus, under the decision below, NJDEP would assert that notwithstanding the specific discharge provision of federal bankruptcy law, 11 U.S.C. §727, the Trustee and the *Quanta* estate would remain obligated for ECRA cleanup responsibility as a condition to any transfer of estate assets. This requirement directly conflicts with the discharge provisions of federal bankruptcy law and is invalid under the supremacy clause.

State environmental laws such as ECRA serve the laudible purpose of protecting the public health through regulation of toxic waste disposal. However, such laws may not frustrate the operation of federal law simply because the state legislature in passing the laws had some purpose in mind other than one of frustration. *Pacific Gas and Electric Company* v. *State Energy Resources Conservation & Development Commission,* 461 U.S. 190, 216, 103 S.Ct. 1713, 75 L.Ed.2d 752, 773 (1983) (footnote 28); *Perez* v. *Campbell,* 402 U.S. at 651, 29 L.Ed.2d at

244-245. The supremacy clause commands that conflicting state laws must fall when they stand as an obstacle to the objectives of federal law.

CONCLUSION

Midlantic National Bank has demonstrated that the decisions of the Third Circuit Court of Appeals below conflict with the rule of statutory construction outlined in *United States* v. *Security National Bank,* 459 U.S. 70, 103 S.Ct. 407, 74 L.Ed.2d 235 (1982). Midlantic has further demonstrated that the Court of Appeals erred in concluding that Congress intended that abandonment under 11 U.S.C. §554(a) be conditioned upon compliance with state environmental laws. Finally, Midlantic has shown that the Court of Appeals erred in concluding that the claims of the state regulatory agencies in these actions are not barred by the supremacy clause of the United States Constitution.

Wherefore, Midlantic National Bank respectfully requests that the decisions of the Court of Appeals be reversed with instruction to affirm the lower court orders approving the abandonment of the burdensome assets of the estate.

Respectfully submitted,

A. Dennis Terrell
Counsel of Record for Petitioner, Midlantic National Bank

Shanley & Fisher, P.C.
Attorneys for Petitioner, Midlantic National Bank

Kenneth S. Kasper
Of Counsel and On the Brief

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